

# Philosophy and Design of Modern Fresh Start Policies: The Evolution of Canada's Legislative Policy

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# Philosophy and Design of Modern Fresh Start Policies: The Evolution of Canada's Legislative Policy

## **Abstract**

The fresh start concept-the restoration of a bankrupt to his or her former debt-free status-originated in the United States. While lip service is paid to it in Canada, the author's review of the English origins and subsequent evolution of Canadian bankruptcy legislation indicates that a strong commitment to the fresh start policy has never been the Canadian philosophy. Rehabilitation of the debtor is not a matter of great concern in Canada. Indeed, the Canadian legislative policy has always been restrictive of the rights of debtors. With the passage of amendments to the Bankruptcy and Insolvency Act (BIA) in 1992 and 1997, the Canadian legislation now is increasingly so with the new rules, new conditions, new restrictions, and new penalties placed in the way of debtors' access to a discharge and a fresh start for bankrupts.

# PHILOSOPHY AND DESIGN OF MODERN FRESH START POLICIES: THE EVOLUTION OF CANADA'S LEGISLATIVE POLICY®

BY JOHN D. HONSBERGER, Q.C.\*

The fresh start concept—the restoration of a bankrupt to his or her former debt-free status—originated in the United States. While lip service is paid to it in Canada, the author's review of the English origins and subsequent evolution of Canadian bankruptcy legislation indicates that a strong commitment to the fresh start policy has never been the Canadian philosophy. Rehabilitation of the debtor is not a matter of great concern in Canada. Indeed, the Canadian legislative policy has always been restrictive of the rights of debtors. With the passage of amendments to the *Bankruptcy and Insolvency Act (BIA)* in 1992 and 1997, the Canadian legislation now is increasingly so with the new rules, new conditions, new restrictions, and new penalties placed in the way of debtors' access to a discharge and a fresh start for bankrupts.

Le concept du nouveau départ—le retour d'une personne en faillite à son statut de non-débiteur—trouve son origine aux États-Unis. Bien qu'on parle du concept au Canada, l'auteur réexamine les origines anglaises et l'évolution subséquente de la législation canadienne sur la faillite, et démontre que la politique du nouveau départ n'a jamais fait parti de la philosophie canadienne. La réhabilitation du débiteur n'est pas d'une grande importance au Canada. En fait, la politique législative canadienne a toujours été restrictive quant aux droits des débiteurs. Avec le passage des amendements de la *Loi sur la faillite et l'insolvabilité* en 1992 et en 1997, la loi canadienne est de plus en plus la même, ayant de nouveaux règlements, de nouvelles restrictions, et de nouvelles peines qui font obstacle à l'accès des débiteurs à l'acquittement et au nouveau départ pour les personnes en faillite.

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## I. INTRODUCTION

There is an old story about an Irishman who was asked how to get to a certain village. The Irishman thought for a while and then said, "If I had wanted to go there I wouldn't have started from here." Any attempt to enunciate or design a modern fresh start policy for bankrupts must start from where we are. It is well to know, too, how we got here and from where. The Canadian search must begin in England, because much of our bankruptcy legislation, attitudes, and values are derived from English precedents and traditions. It is also well to be reminded of the fundamental purpose of bankruptcy, and of the symmetry of the bankruptcy system, when tracing the evolution of Canada's fresh start policy.

## II. THE FUNDAMENTAL PURPOSE OF BANKRUPTCY AND A DISCHARGE

The fundamental purpose of bankruptcy legislation, as it has always been understood, is the liquidation of the debtor's estate and its division among the debtor's creditors. This, however, does not mean quite the same thing today as it did before World War II, since more and more debtors—particularly consumer debtors—have no estate to be liquidated.

The fundamental purpose of the discharge, which relates to the effect bankruptcy has on the liability of the bankrupt, is to facilitate and maximize the liquidation of the debtor's estate. Increasingly, the discharge is considered to be a means to other economic and social ends. It does represent, however, a gradual realization that in many cases, the bankrupt might properly be considered an object of pity. This is the basis of the fresh start concept.

### III. ORIGIN OF THE FRESH START CONCEPT

One of the earliest expressions of the fresh start concept appeared in the decision of the United States Supreme Court in *Williams v. U.S. Fidelity Co.*, where it was said:

It is the purpose of the Bankrupt Act to convert the assets of the bankrupt into cash for distribution among creditors and then to relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.<sup>1</sup>

This statement was followed and quoted with approval by the Court in *Local Loan Co. v. Hunt*,<sup>2</sup> in which it was said:

The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much as, if not more than, it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern. From the viewpoint of the wage earner there is little difference between not earning at all and earning wholly for a creditor. Pauperism may be the necessary result of either ... The new opportunity in life and the clear field for future effort, which is the purpose of the bankruptcy act to afford the emancipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy.<sup>3</sup>

The Supreme Court of Canada, shortly thereafter, said much the same when it wrote that “[t]he purpose and object of the *Bankruptcy Act* is to equitably distribute the assets of the debtor and to permit of his rehabilitation as a citizen, unfettered by past debts.”<sup>4</sup>

In their respective articulations of the purpose of bankruptcy legislation, both the United States Supreme Court and the Supreme Court of Canada conceived the fresh start as the restoration of the bankrupt to his or her former debt-free status. (The courts were referring to business debtors, not consumer debtors.) This interpretation matches the definition of “rehabilitation” in the Shorter Oxford English Dictionary as a restoration to a previous condition.<sup>5</sup> A broader definition

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<sup>1</sup> 236 U.S. 549 at 554-55 (1915), McReynolds J. [hereinafter *Williams*]. The term “fresh start” probably originated in the United States Supreme Court decision in *Wetmore v. Markoe*, 196 U.S. 68 at 77 (1904).

<sup>2</sup> 292 U.S. 234 at 244 (1934), Sutherland J. [hereinafter *Local Loan Co.*].

<sup>3</sup> *Ibid.* at 245.

<sup>4</sup> *Industrial Acceptance Corp. v. Lalonde*, [1952] 2 S.C.R. 109 at 120, Estey J. [hereinafter *Lalonde*].

<sup>5</sup> See *The Shorter Oxford English Dictionary*, 3d ed., s.v. “rehabilitation.”

of rehabilitation is now favoured. This excludes any concept of the restoration of a bankrupt to his or her previous condition, which is now deemed not to be desirable. It means instead a change in the economic attitudes and values of a bankrupt to ones that are more socially acceptable, and will improve his or her social and economic situation.<sup>6</sup> The modern interpretation of rehabilitation, which is often used in the place of a fresh start, reminds us of Humpty Dumpty, who said in rather a scornful tone, "When *I* use a word it means just what I choose it to mean—neither more nor less."<sup>7</sup>

#### IV. THE ROLE OF EQUITY IN LEGISLATIVE AND JUDICIAL POLICY

The Supreme Court of Canada's interpretation of the *Bankruptcy Act* in *Lalonde*,<sup>8</sup> when it said the object of the *Act* is to distribute the assets of the debtor equitably, is a reminder that bankruptcy has always been within the jurisdiction of the courts of equity. There are many equitable maxims that apply to bankruptcies and discharges, and to a fresh start in particular, including: "Those who seek equity must do equity;" "those who come to equity must come with clean hands;" "equality is equity;" "equity imputes an intention to fulfil an obligation;" and "equity will not suffer a wrong to be without a remedy." Judicial and legislative policy is often based upon, or influenced by, these equitable principles. Equity has had, and should continue to have, a strong influence on the development of fresh start policies.

#### V. ENGLISH LEGISLATION

The first English legislation to show apparent concern (and I use the word "apparent" advisedly) for the rehabilitation of the debtor (and "rehabilitation" was not used as we now understand it) was enacted in 1705 in the reign of Anne.<sup>9</sup> The discharge provided by this statute was not

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<sup>6</sup> See generally J. Lee, "What Shall We Do for the Consumer Bankrupt?" (1970) 44 J. Nat'l Assoc. Ref. Bankr. 9.

<sup>7</sup> L. Carroll, *Alice's Adventures in Wonderland & Through the Looking-Glass* (New York: Penguin Books, 1960) at 188.

<sup>8</sup> *Supra*, note 4.

<sup>9</sup> See *An act to prevent frauds frequently committed by bankrupts*, 1705 (U.K.), 4 Anne, c. 17 [hereinafter *1705 Act*].

designed out of consideration for the debtor, but was intended, rather, to be a reward for debtors who cooperated in the administration of their estates. The penal provisions preceding the *1705 Act*, which related to the duty of debtors to surrender their estates for administration, had not evoked satisfactory cooperation. The legislators sought to do better. A debtor who was a merchant, for example, could get a discharge of all his debts owing at the time of bankruptcy, provided he surrendered all of his property and conformed to the other provisions of the statute. The legislators, however, remained very much aware of the continuing problem of the fraudulent debtor. So, while given new privileges, the debtor had to be free from fraud and submit himself to the control of the court.

The severity of the penalty for failing to strictly comply with the law was evidence of the concern that debtors might abuse the privileges given to them. In the past, the penalty had been to stand in the pillory or to have an ear cut off. The new penalty was hanging. This penalty applied, for example, if the bankrupt failed to surrender himself to the court, committed perjury on his examination, or fraudulently concealed his assets.<sup>10</sup>

Another early concern of Parliament—of increasing contemporary concern as well—was that a debtor might enter bankruptcy without any assets to be divided among his or her creditors, and still seek a discharge. For example, *The Bankrupt Law Consolidation Act, 1849* required a petitioner for bankruptcy to state that he “verily believes that he can make it appear to the Satisfaction of the Court that his available Estate is sufficient to pay his Creditors at least Five Shillings in the Pound.”<sup>11</sup> If this could not be proved to the satisfaction of the court, the petition was dismissed.<sup>12</sup> To this point there was still no concern with the rehabilitation of the debtor; the principal concerns were the creditor’s welfare, and that equity was done. If the debtor brought nothing into bankruptcy, could the debtor in good conscience expect to take anything away? A debtor who seeks equity must do equity.

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<sup>10</sup> See The Hon. R.H. Eden, “A Practical Treatise on the Bankrupt Law, as Amended by the New Act of the 6 Geo. IV c. 16” in T.I. Wharton, Esq., ed., *The Law Library* (Philadelphia: John S. Littell, 1842) Vol. XIX at 292, in which The Honourable Robert Henley Eden wrote that

[t]he punishment of death for not surrendering or submitting to be examined, or for concealing property, was first introduced by the 4 and 5 Ann [*sic*], continued by the 5 Geo. 1, and afterwards by the 5 Geo. 2, c. 30; and it was not till the reign of his present majesty that the penalty was changed to the milder one of transportation ...

The statute of “his present majesty” is 1821 (U.K.), 1&2 Geo. IV, c. 115.

<sup>11</sup> (U.K.), 12 & 13 Vict., c. 106, sch. O.

<sup>12</sup> *Ibid.* s. XCIII.

It was difficult to prove at the commencement of a bankruptcy that the assets of a debtor were sufficient to pay his creditors at least five shillings in the pound. Accordingly, the *Bankruptcy Act, 1854* came up with a different formula; it required the debtor to make it appear that his available estate was at least sufficient to produce the sum of 150 pounds.<sup>13</sup> If the debtor could not prove this, his petition was dismissed.

Although there were many other English bankruptcy statutes that became drafting precedents for early Canadian bankruptcy legislation, they were all similar in concept to the statutes of 1849 and 1854. There was no concern with the rehabilitation of the debtor; all that mattered was maximizing the realization of the debtor's estate for the benefit of the creditors. But there was a price to pay for being accepted into bankruptcy and receiving the reward of a discharge: a debtor had to bring into court a bare minimum of assets to be applied against the claims of creditors.

## VI. PRE-CONFEDERATION CANADIAN LEGISLATION

When the laws of England were introduced into Upper Canada in 1792, all laws in relation to bankrupts were excluded.<sup>14</sup> However, by the time of Confederation in 1867, insolvency legislation had been adopted in Upper and Lower Canada, and in Nova Scotia. Although they were not then members of Confederation, British Columbia, Prince Edward Island, and Newfoundland had also adopted bankruptcy legislation.

The pre-Confederation legislation of the Province of Canada, (*i.e.*, Canada East and Canada West, now Ontario and Quebec), evolved into the first federal post-Confederation legislation. The Parliament of the Province of Canada passed a general bankruptcy law in 1843, which repealed an earlier Ordinance of 1839.<sup>15</sup> The *1843 Act* had stringent discharge provisions. If the debtor made full disclosure of his estate and effects "and in all things conformed himself to the provisions of this Act" he would be discharged of his debts due at the date of his bankruptcy.<sup>16</sup> A

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<sup>13</sup> (U.K.), 17 & 18 Vict., c. 119, s. XX.

<sup>14</sup> See *An act to repeal certain parts of an Act passed in the fourteenth year of His Majesty's Reign, entitled, "An act making more effectual provision for the government of the province of Quebec, in North America and to introduce the English law as the rule of decision in all matters of controversy, relative to property and civil rights," 1792 (U.K.), 32 Geo. III, c. 1, preamble.*

<sup>15</sup> See *An Act to repeal an Ordinance of Lower Canada, intituled, An Ordinance concerning Bankrupts, and the administration and distribution of their estates and effects, and to make provision for the same object throughout the Province of Canada, 1843 (Can.), 7 Vict., c. 10 [hereinafter 1843 Act].*

<sup>16</sup> *Ibid.* s. LIX.



discharge would not be given, however, if the debtor had incurred certain types of debts through wagering or gaming; if he concealed, mutilated, or destroyed any of his books, papers, or records; if he made false entries in his accounts with the intent to defeat his creditors; if he concealed any part of his property; or if he did not disclose any false proof of claim within one month after becoming aware of it.<sup>17</sup>

The discharge provided by the *1843 Act* favoured creditors, and was very much a reward to the honest debtor with an unblemished record who assisted to the utmost in the administration of his estate. If, however, the debtor had engaged in certain conduct before proceedings were commenced, he was absolutely disentitled to a discharge. Even when authorized, a discharge was given reluctantly. The *1843 Act* was predominantly creditor oriented, as was other English legislation at that time.

Three years before Confederation, the *1843 Act* and amending Acts expired and were replaced by *The Insolvent Act of 1864*.<sup>18</sup> In Lower Canada this *Act* applied only to traders, but it applied to all persons in Upper Canada. Its discharge provisions<sup>19</sup> were similar to the *1843 Act* but with a new, and moderately more liberal, provision: if after one year from the date proceedings had commenced the debtor had not obtained the required proportion of creditors to consent to his discharge, he could make an application directly to the court for a discharge.<sup>20</sup>

## VII. POST-CONFEDERATION CANADIAN LEGISLATION

The first federal statute for bankruptcy and insolvency after Confederation was *The Insolvent Act of 1869*.<sup>21</sup> It was very similar to the pre-Confederation *1864 Act* but with harsher discharge provisions. These provisions required the debtor to first obtain the consent of a majority of creditors who, respectively, were creditors for amounts of one hundred dollars and upwards, and who represented at least three-quarters or more of the debtor's liabilities.<sup>22</sup> The debtor was then required, on notice to all creditors, to apply to the court to confirm the discharge. If any of six

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<sup>17</sup> *Ibid.* s. LX.

<sup>18</sup> (Can.), 27-28 Vict., c. 17 [hereinafter *1864 Act*].

<sup>19</sup> *Ibid.* s. 9.

<sup>20</sup> *Ibid.* s. 9(10).

<sup>21</sup> (Can.), 32-33 Vict., c. 16 [hereinafter *1869 Act*].

<sup>22</sup> *Ibid.* s. 94.

grounds of opposition were proved, the court was required to refuse the discharge.<sup>23</sup> However, if there was insufficient evidence to sustain any of these grounds, but any of another five grounds were proven, the court could suspend the discharge for a period not exceeding five years, declare the discharge to be "of the second class," or do both.<sup>24</sup>

A discharge "of the first class" was awarded to the debtor whose insolvency arose out of unavoidable losses and misfortunes; that is, the honest and unfortunate debtor. All other debtors who were granted a discharge were branded with a second class discharge. This was much like the early New England practice, described in Nathaniel Hawthorne's *The Scarlet Letter*,<sup>25</sup> of forcing a woman who had committed adultery to wear the letter "A." A second class discharge was intended to keep the disgrace of bankruptcy alive forever, or at least as long as the bankrupt lived. Undoubtedly this was intended to distinguish the "better" kind of bankrupt from the disreputable kind, to allow the trading community to avoid giving credit to those who had already shown themselves unworthy of it. A discharge, once obtained, whether of the first or second class, did not apply to eleven separate classes of debt if the creditor did not file a proof of claim.<sup>26</sup>

The legislative policy respecting discharges under the *1869 Act* was that a discharge would be granted only grudgingly and with little, if any, concern for the debtor. Like the *1705 Act*, it was a reward granted to those debtors who assisted in the administration of their estates. There was otherwise no concern for the debtor's rehabilitation, nor any thought of a "fresh start."

The year 1880 marked the beginning of a new period concerning Canadian legislative policy for discharges. Between 1874 and 1878 a serious depression resulted in many commercial failures. This caused much public resentment, particularly in Western Canada; while eastern farm-implement dealers were able to use the *1869 Act* when they could not meet their debts, western farmers—unable to meet the classification of "trader" under the *Act*—had to pay what they owed in full. These and other grievances led in 1880 to a repealing statute,<sup>27</sup> by which the federal government abandoned its legislative role in the bankruptcy and

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<sup>23</sup> *Ibid.* s. 101.

<sup>24</sup> *Ibid.* s. 103.

<sup>25</sup> See N. Hawthorne, *The Scarlet Letter* (New York: Bantam Books, 1981).

<sup>26</sup> See *1869 Act*, *supra* note 21, s. 100.

<sup>27</sup> See *An Act to repeal the Acts Respecting Insolvency now in force in Canada*, 1880 (Can.), 43 Vict., c. 1.

insolvency area. It would seem that it felt it was dealing with a politically sensitive topic and was glad to get out of the bankruptcy business. At this point, it is safe to say that there was no federal legislative policy respecting a fresh start.

It was soon found, however, that without insolvency or bankruptcy legislation there was no way to wind up insolvent companies. Boards of trade in most large cities passed resolutions requesting new legislation. As a result, the federal government passed *An Act respecting Insolvent Banks, Insurance Companies, Loan Companies, Building Societies and Trading Corporations*,<sup>28</sup> later to be known as the *Winding Up Act*.<sup>29</sup> Since this was the only federal insolvency legislation, restricted in application to insolvent companies, the provincial legislatures were compelled in the interest of commercial discipline to exercise their much less extensive powers. Quebec had former articles 763-780 of its *Code of Civil Procedure*,<sup>30</sup> and the common-law provinces adopted assignments and preferences legislation.<sup>31</sup>

What characterizes the provincial legislation, and since 1919 has distinguished it from the federal bankruptcy and insolvency legislation, is that a creditor cannot force a debtor to make an assignment. Further; once an assignment is made, there is no provision permitting a debtor to make an arrangement with his or her creditors, and a debtor does not receive a release of his or her debts. Again, a creditor retains its claim for the balance outstanding after receiving its dividend and, by obtaining judgment, prevents the debtor from resuming business (at least in his or her own name) even if the other creditors are willing to release the debtor. Many debtors stopped paying taxes, limited their occupational efforts, and often deserted their families.

Debtors who wished to return to business were often driven to means flavouring of trickery and deception to re-establish their livelihood. A number of strategies were used. Debtors might leave the country, carry on business in the names of wives, incorporate limited liability companies, obtain precarious credit, await the operation of the statute of limitations, or obtain a discharge from those creditors who were willing to grant it, and settle with or pay the others.

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<sup>28</sup> 1882 (Can.), 45 Vict., c. 23.

<sup>29</sup> R.S.C. 1886, c. 129.

<sup>30</sup> See Arts 763-80 C.C.P. (1888).

<sup>31</sup> This legislation is still in effect. See, for example, Ontario, *Assignments and Preferences Act*, R.S.O. 1990, c. A-33.

It would be valuable to have a profile of the insolvent debtors who made assignments under provincial assignments and preferences legislation. It would seem that by far the majority, indeed almost all, were business and professional men. There were few, if any, consumers among insolvent debtors, since there was little consumer credit at the time, and few consumers would have had enough property to assign to pay even the costs of administration.

There were some insolvent debtors who did not mind the fact that they could not get a discharge. Apparently they were able in some way to support themselves and their dependants, although there is very little discussion of their situation in either newspapers or professional journals of the day, and when the debate began it related only to traders.<sup>32</sup> It would be interesting to know what percentage of our present-day, low-income consumer debtors care if they have access to discharge facilities.

A groundswell of support gradually developed for the passage of bankruptcy legislation that would apply across the country. This resulted in 1919 in the *Bankruptcy Act*.<sup>33</sup> It was described as a war measure. In the debate in the House of Commons it was said: "We must be prepared when the war comes to a close, to be able to handle the situation which is bound to arise in this country as a result of the long-continued struggle ... ." <sup>34</sup> There was reference also to the need to separate the "sheep" from the "goats," and "[w]hen the court is of the opinion that a debtor has been obliged to assign through misfortune, he shall be given the necessary relief."<sup>35</sup> This sounds similar to the fresh start concept enunciated by the United States Supreme Court just a few years earlier in *Williams*.<sup>36</sup> Canada, however, did not have the same view of the fresh start. It did not then and has not since gone as far as the United States did in implementing *An Act To establish a uniform system of bankruptcy throughout the United States*.<sup>37</sup> This American *Act* effectuated a fresh start policy, which provided that property acquired after the filing of the petition belongs to the bankrupt, free of the claims of creditors as of that

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<sup>32</sup> See, for example, "Insolvency Legislation" Editorial Comment (1899) 35 Can. L.J. 179.

<sup>33</sup> 1919 (Can.), 9 & 10 Geo. V, c. 36 [hereinafter *1919 Act*].

<sup>34</sup> *House of Commons Debates* (27 March 1918) at 206 (Mr. Jacobs).

<sup>35</sup> *Ibid.*

<sup>36</sup> *Supra* note 1.

<sup>37</sup> c. 541, 30 Stat. 544 (1898) [hereinafter *Bankruptcy Act 1898*].

date.<sup>38</sup> Rather, the *1919 Act* provided (as the current Canadian legislation still does) that “all property which may be acquired by or devolve on [the bankrupt] before his discharge” vested in his trustee.<sup>39</sup>

The United States *Bankruptcy Code* does not allow a conditional or suspended discharge.<sup>40</sup> A discharge is either granted or it is refused. The Canadian *1919 Act* provided that the court could either grant or refuse an absolute discharge, suspend it for a specified time, or grant an order subject to any conditions requiring the debtor to turn over part of his or her earnings.<sup>41</sup> The court was compelled to refuse a discharge in a few situations “unless for special reasons the court otherwise determines ... .”<sup>42</sup> The court was also required to refuse a discharge,<sup>43</sup> make a conditional discharge,<sup>44</sup> or suspend a discharge for not less than two years<sup>45</sup> where there was proof of any of eleven specified facts.<sup>46</sup> The fact most frequently proved was that the assets of the bankrupt were not of a value equal to fifty cents on the dollar of his or her unsecured liabilities, but in this case the suspension could be for less than two years.<sup>47</sup> Invariably, when the assets were less than fifty cents on the dollar

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<sup>38</sup> The current United States Bankruptcy Code provides that all of a bankrupt’s property *as of the commencement of the case* becomes property of the estate: see 11 U.S.C. § 541(a)(1) (1998) [hereinafter *Bankruptcy Code*].

<sup>39</sup> *1919 Act*, *supra* note 33, s. 25(a).

<sup>40</sup> It has been proposed from time to time that the United States *Bankruptcy Code* should be amended to include a conditional or suspended discharge. President Hoover’s Message to Congress on 29 February 1932, S. Doc. No. 65, at XII (1932), said in part,

The discretion of courts in granting or refusing discharges should be broadened, and they should be authorized to postpone discharges for a time and require Bankrupts, during the period of suspension, to make some satisfaction out of after acquired property as a condition to the granting of a full discharge.

In the *Handbook of the Law of Bankruptcy* (St. Paul, Minn.: West, 1956) at 113, James A. MacLachlan wrote of the proposal that,

[i]t evoked much opposition. The preponderantly conservative membership of the National Bankruptcy Conference and others found that this foreign innovation would confer undue powers on the individual judge and create a condition of semi-peonage or subserviency on the part of the bankrupt which was not in accordance with the best American tradition.

<sup>41</sup> See *1919 Act*, *supra* note 33, s. 58(4).

<sup>42</sup> *Ibid.* s. 58(5).

<sup>43</sup> *Ibid.* s. 58(5)(a).

<sup>44</sup> *Ibid.*

<sup>45</sup> *Ibid.* s. 58(5)(b).

<sup>46</sup> *Ibid.* ss. 59(a)-(k).

<sup>47</sup> *Ibid.* s. 58(5)(b).

the suspension was for three months or so, provided there was no other improper conduct on the part of the debtor.

After a year from the time that a conditional order was made, the court could modify the order if the bankrupt proved there was no realistic probability of his or her being in a position to comply with the terms or conditions of the order.<sup>48</sup> Once a discharge was ordered, all but four classes of debt were released.<sup>49</sup> While on the face of the *1919 Act* the discharge provisions appeared to be harsh, there was considerable flexibility enabling the court to reach an appropriate compromise between the conflicting interests of the creditors and the bankrupt in the event that the conduct of the bankrupt was not what it should be.

For the most part, the discharge provisions worked reasonably well. Unexpectedly, however, a large number of bankrupts did not apply for their discharges. No attempt seems to have been made over the years to ascertain why this was so. Many bankrupts, perhaps, did not know that they were entitled to apply. Others might not have wanted to make the effort. Still others might have been deterred by the cost. However, the most compelling reason why so many did not apply for a discharge is undoubtedly that they felt they did not need it. This was because they had so little property—and so little expectation of acquiring any—that creditors might seize, or because they did not intend to go into business in any significant way. Some debtors might not have cared whether they obtained a discharge, and might have considered that they could get by without one. Whatever the reason, the experience under the *1919 Act* and the earlier experience under the assignments and preferences legislation is likely to influence modern legislative policy concerning a fresh start.

After twenty years, it became apparent that the *1919 Act* could and should be improved. A new Act was almost completely drafted by 1939, but the war delayed its finalization until 1949.<sup>50</sup> Although enacted in 1949, it represents the thought and policies of 1939. With substantial amendments, the *1949 Act* is the present *Bankruptcy and Insolvency Act (BIA)*.<sup>51</sup>

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<sup>48</sup> *Ibid.* s. 58(5).

<sup>49</sup> *Ibid.* ss. 61(1)(a)-(d).

<sup>50</sup> See *Bankruptcy Act, 1949* (Can.), 13 Geo. VI, c. 7 [hereinafter *1949 Act*].

<sup>51</sup> R.S.C. 1985, c. B-3 [hereinafter *BIA*], as am. by *An Act to amend the Bankruptcy Act and to amend the Income Tax Act in consequence thereof*, S.C. 1992, c. 27, s. 2 [hereinafter *1992 Amendments*].

The intention of the 1949 Act was said to be "to clarify and simplify the legislation."<sup>52</sup> One innovation was the introduction of a summary administration for small estates, which provided an economical and inexpensive alternative to the old provisions.<sup>53</sup> This made it easier for a small debtor to enter bankruptcy voluntarily. The principal innovation, however, was the provision for an automatic application for a discharge once the bankruptcy proceedings were commenced.<sup>54</sup> It was intended to facilitate the procedure for a discharge, and to reduce the number of undischarged bankrupts. The number of debts not released by a discharge was expanded to seven<sup>55</sup> from the four types that appeared in the 1919 Act.<sup>56</sup>

Concern over the rising number of consumer bankruptcies began to develop in the 1960s.<sup>57</sup> Some asked whether the traditional bankruptcy process could provide an adequate remedy to the problem of the insolvent consumer. The cost of a trustee was one stumbling block. The Superintendent of Bankruptcy developed an *ad hoc* system whereby trustees were made available at a reduced cost to indigent consumers.

Several Western provinces enacted orderly payments of debts legislation, which permitted debtors to make, at a minimal cost, an arrangement with their creditors for the payment of all or part of the debts as an alternative to bankruptcy. This permitted the debtor to maintain his or her self-respect and to learn how to handle his or her finances. However, in 1960 the Supreme Court of Canada held that Alberta's *The Orderly Payment of Debts Act*<sup>58</sup> was *ultra vires* the provincial legislature as encroaching upon the federal jurisdiction over bankruptcy and insolvency.<sup>59</sup> The Alberta legislation had not been proclaimed, but a similar Act of the province of Manitoba had been in force since 1932.<sup>60</sup>

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<sup>52</sup> Canada, *Bankruptcy and Insolvency: Report of the Study Committee on Bankruptcy and Insolvency Legislation* (Ottawa: Information Canada, 1970) (Chair: R. Tassé) at 17 [hereinafter "Tassé Committee"].

<sup>53</sup> See 1949 Act, *supra* note 50, s. 114.

<sup>54</sup> *Ibid.* s. 127(1).

<sup>55</sup> *Ibid.* ss. 135(1)(a)-(g).

<sup>56</sup> See note 49, *supra*.

<sup>57</sup> This was one of the reasons for the appointment of the Tassé Committee in 1966. The rising number of consumer bankruptcies was frequently referred to by organizations that submitted written memoranda to the Committee.

<sup>58</sup> S.A. 1959, c. 61.

<sup>59</sup> See *Validity of The Orderly Payment of Debts Act, 1959 (Alta.)*, [1960] S.C.R. 571.

<sup>60</sup> See *Orderly Payment of Debts Act*, S.M. 1932, c. 34.

Both Manitoba and Alberta then requested the enactment of federal legislation of the same character as the provincial legislation.

There was no sense of urgency on the part of the federal government to amend the federal bankruptcy legislation, but it finally agreed, and in July 1966 it amended the *Bankruptcy Act* by adding Part X.<sup>61</sup> The amendment provided for an orderly payment of debts scheme substantially similar to the earlier legislation in Alberta and Manitoba. The payment of debts could be extended, but the debts had to be paid in full. A discharge was not available. Part X was only available in those provinces that requested it to apply to them and were prepared to pay the cost of its administration.

Federal legislative policy at the time was to go slow, perhaps with the thought that if nothing was done the problem would go away. However, the federal government came under increasing pressure to do something. It accordingly appointed the Tassé Committee in 1966 "to review and report on the bankruptcy and insolvency legislation of Canada."<sup>62</sup> The Tassé Committee presented its report in 1970. Among a great many other matters, it expressed concern over the social dimensions of bankruptcy, the rehabilitation of debtors, and the bankrupt's need for an opportunity to make a fresh economic start. It said in this regard:

*The Social Dimension of Bankruptcy:* From the social point of view, the fact that a citizen is over-burdened with debts or harassed by his creditors may be the source of much evil. Through his inability to solve his financial problems and support himself and his family, much hardship and unhappiness may result to him, his family and the country at large. "The tensions built up in harassed individuals and families frequently contribute to family breakdown, mental illness, crime and economic dependency."

Bankruptcy is, today, the "escape door" to the harassed or over-burdened debtor. In the past, it has taken many other forms. We have seen, for example, how, in ancient times, a debtor would pledge and, perhaps later, sell his wife and children to escape the barbaric punishment that was the fate of those who could not pay their debts in full. In the Middle Ages, it was a common practice for such a debtor to escape his creditors by becoming an outlaw or by fleeing the country. Whenever the right to bankruptcy as an "escape door" is restricted, or when it is too difficult to become bankrupt, there is a great danger that debtors will resort to crime and desert their families they can no longer support and their responsibilities they can no longer face.

There is also a great social waste in having a large class of harassed or over-burdened debtors and of undischarged bankrupts. One of the principal objectives of the new act should be to minimize this waste and to make the most of the human resources represented by this group of debtors. Speedy and effective measures to promote their social and economic rehabilitation are imperative. A debtor should be able, and should be encouraged, to make an arrangement with his creditors, when he has the ability to pay his

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<sup>61</sup> See *An Act to amend the Bankruptcy Act*, S.C. 1966, c. 32, s. 22.

<sup>62</sup> Tassé Committee, *supra* note 52 at xi.



debts in whole or in part. When the burden of debt becomes too great, a debtor should not be prevented from entering bankruptcy. Once in bankruptcy, a debtor should be encouraged, subject to appropriate safeguards, to become, as quickly as possible, a self-supporting and productive member of his community. Measures must also be designed to protect the discharged debtor from the pressure of creditors endeavouring to persuade him to undertake to pay his discharged debts, thereby defeating one of the primary purposes of the Act.

*The System must Facilitate the Rehabilitation of the Debtor:* Indeed, we believe that, in respect of the individual debtor, the principal objective of the bankruptcy system should be to rehabilitate him and give him an opportunity to make a fresh economic start in life. Whether the debtor is good or bad should not affect his right in this regard. All debtors should be encouraged to become self-supporting as quickly as possible and be protected from the harassment of their creditors. There should be no bar to a debtor seeking employment, retaining what he earns and providing for the care and security of himself and his dependants. Equity would, however, demand that, where a large amount of property is retained by a bankrupt by reason of the appropriate exemption statutes, his right to be released of his debts should not be absolute. Equity would also demand that, if a debtor, within a certain period of time after his bankruptcy, acquires great wealth, he should be called upon to share it with his creditors.

This approach would emphasize, as we think it should, the civil, as opposed to the quasi-criminal, character of the bankruptcy process. The fact that the debtor has committed an offence for which he would have an answer under relevant statutes should not deprive him of the opportunity to make a fresh economic start in life.<sup>63</sup>

The report was accepted almost in its entirety and it might be said that it represented a legislative fresh start policy. The government's political will, however, began to waver. Several bills for new acts were introduced in Parliament but were never passed and were allowed to lapse.

In the meantime, a new problem arose. For several reasons, the agricultural industry suffered from a severe economic depression in the 1980s. When lenders attempted to foreclose on farm mortgages, several farmers responded with acts of civil disobedience. The Department of Consumer and Corporate Affairs, which had the legislative responsibility for bankruptcy and insolvency, dithered. Eventually, the Department of Agriculture, with some exasperation, proposed the *Farm Debt Review Act*,<sup>64</sup> which was enacted in 1985. During the debate on the bill, the minister of agriculture said that it was intended to help farmers with potentially viable operations to remain in business.<sup>65</sup> In other words, a fresh start was provided for those who had the capacity to use it.

The recessions of the 1980s and 1990s led to a dramatic increase in bankruptcy filings, and aroused concern on the part of government, the

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<sup>63</sup> *Ibid.* at 86-87 [footnote omitted].

<sup>64</sup> R.S.C. 1985 (2nd Supp.), c. 25.

<sup>65</sup> See *House of Commons Debates* (20 June 1986) at 14,790 (Mr. Wise).

courts, and others. There was a feeling that somehow the moral fabric of society had been weakened. Insolvent debtors were criticized for doing what the *BIA* permitted them to do. The critics argued that bankruptcy was not a process to be used by a debtor to avoid his or her responsibilities to the maximum extent that the debtor was able to do so.<sup>66</sup> Likewise, they complained it was an abuse of the *BIA* for a debtor to go into bankruptcy as a convenient means to evade payment of just obligations, and to obtain a discharge without difficulty.<sup>67</sup>

It was apparent that the stigma of bankruptcy was not preventing the door to the bankruptcy court from being thrown wide open.<sup>68</sup> The reaction was much like it was when all of a sudden an acorn fell and hit Henny Penny on the head. She rushed into the barnyard and shouted, "Goodness gracious, the sky is falling." The result has been much legislative tinkering that was not always well considered.<sup>69</sup>

Under the *BIA*, first-time bankrupts can receive an automatic discharge unless there is an objection.<sup>70</sup> This provision, however, was designed as much to relieve over-burdened courts as to assist bankrupts. Generally, the legislation as it affects individual debtors has become harsher. The legislative policy of a fresh start is qualified. First, a new regime for consumer proposals, in addition to the existing provisions on

<sup>66</sup> See *Re Junger* (1986), 60 C.B.R. (N.S.) 86 at para. 16 (Ont. S.C.).

<sup>67</sup> See *Re Posner* (1960), 3 C.B.R. (N.S.) 49 at para. 19 (Man. Q.B.), Ferguson J. quoting with approval from *Lalonde*, *supra* note 4.

<sup>68</sup> There was an underlying assumption in the old bankruptcy legislation that there was an economic and social stigma attached to bankruptcy. Most people took pride in paying their debts and it was a matter of shame for them and their families when they could not. The disgrace of bankruptcy is no longer what it was. An increasing number of persons accept bankruptcy as a solution to their financial troubles. To many, what is legally right is morally right, and individual bankruptcy is not a disgrace but just smart business tactics: see F.C. Fields, "Needed Changes in Individual Bankruptcy" in *Proceedings of Oklahoma Institute of Consumer Credit Management for 1959* (Oklahoma City: Oklahoma City University, 1959) at 7. However, the Tassé Committee, *supra* note 52, wrote, at 55, that "[t]he disgrace of bankruptcy, more than any legal sanction, effectively removed the bankrupt from business and thereby protected both the business community and the public from the incompetent or dishonest businessman." See also The Gallup Organization, *The Public's Attitudes Toward Bankruptcy* (Princeton, N.J.: The Gallup Organization, 1966).

<sup>69</sup> See *Statute Law (Canadian Charter of Rights and Freedoms) Amendment Act*, R.S.C. 1985 (1st Supp.), c. 31, ss. 3, 28, 69-77; *Farm Debt Review Act*, R.S.C. 1985 (2nd Supp.), c. 25; *An Act to amend the Judges Act and other Acts in relation to judicial matters*, R.S.C. 1985 (2nd Supp.), c. 27, s.10; 1992 Amendments, *supra* note 51; *Miscellaneous Statute Law Amendment Act, 1993*, S.C. 1993, c. 34, s. 10; *Miscellaneous Statute Law Amendment Act, 1994*, S.C. 1994, c. 26, ss. 6-9; and *An Act to amend the Bankruptcy and Insolvency Act, the Companies' Creditors Arrangement Act and the Income Tax Act*, S.C. 1997, c. 12 [hereinafter 1997 Amendments].

<sup>70</sup> See *BIA*, *supra* note 51, s. 168.1.

the orderly payment of debts, has been established.<sup>71</sup> Second, debtors who can make a viable proposal primarily by the use of after-acquired salary, wages, or other remuneration are penalized if they instead choose bankruptcy.<sup>72</sup> Third, debtors who choose bankruptcy can be required to make payments from their excess income during and after the administration of their bankruptcy, as established by directives of the Superintendent of Bankruptcy.<sup>73</sup> It is relevant to note how far Canada has digressed from the philosophy of *Local Loan Co.*<sup>74</sup> (although admittedly never the philosophy of the Canadian legislation), which held that the power of an individual to earn a living for himself and his dependants is a personal liberty as much as, if not more than, it is a property right.

Further changes among the recent amendments that qualify a fresh start policy include the provision that debtors are obliged to submit to counselling,<sup>75</sup> and the restrictions placed on the discharge of student loan debts.<sup>76</sup> Significantly, the number of debts that are not released by a discharge have grown from four in the *1919 Act* to seven in the *1949 Act* and to nine in the *1997 Amendments*.<sup>77</sup> The quasi-criminal nature of bankruptcy has also been revived. Although fraudulent and dishonest bankrupts should be penalized, it would seem more appropriate, in order to preserve the integrity of the *BIA*, to use the criminal law to punish them rather than bankruptcy law.

Presumably the thrust of these amendments is to assist creditors. However, when taking into account the mark-up usually made by commercial creditors on goods and services for bad debts (compared to the actual level of default), and the ability to write off losses against profits for income tax purposes, their actual losses are minimal. The amendments also fail to take into account the effect on bankruptcy filings of the greatly expanded availability of credit. Even though irresponsible borrowing by debtors is criticized, the irresponsible extension of credit is not. Similarly, debtors are penalized for not paying off student loans, which are often so large as to be unmanageable, while there is little criticism of our governments' failure to extend public education beyond the secondary school level. Governments, even if they do not encourage

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<sup>71</sup> *Ibid.* ss. 66.11-66.4 (Consumer Proposals), as am. by *1992 Amendments*, *supra* note 51, s. 32.

<sup>72</sup> See *BIA*, *supra* note 51, s. 173(1)(n), as am. by *1997 Amendments*, *supra* note 69, s. 103(1).

<sup>73</sup> See *BIA*, *supra* note 51, ss. 68.1, 170.1.

<sup>74</sup> *Supra* note 2.

<sup>75</sup> See *BIA*, *supra* note 51, s. 157.1, as am. by *1992 Amendments*, *supra* note 51, s. 58.

<sup>76</sup> See *BIA*, *supra* note 51, s. 178(g), as am. by *1997 Amendments*, *supra* note 69, s. 105.

<sup>77</sup> See *BIA*, *supra* note 51, s. 178, as am. by *1997 Amendments*, *supra* note 69, s. 105.

students to borrow beyond their means to obtain a higher education for the ultimate benefit of society, have stood by and condoned the practice. While some students may borrow from governments with no intention to repay, there are debtors who borrow money for other purposes with no intention to repay, without being subject to comparable penalties.

## VIII. CONCLUSION

The most recent legislative tinkering is myopic in locating the reasons for consumer bankruptcies. There has been little distribution in the assignment of responsibility. While lip service is paid to a fresh start philosophy, the legislative policy is more restrictive than it formerly was. There are new rules, new conditions, new restrictions, and new penalties. We have moved from "a society being governed by the rule of law to a society governed by the law of rules."<sup>78</sup> This is particularly true to the prospect of obtaining a fresh start. We seem to have moved backwards. A Kafkaesque situation has developed regarding discharges in bankruptcy and the fresh start for bankrupts. If the average layperson understood how the system has evolved and what it has become today, he or she would find it ridiculous and depressing. A maximum of effort, verbiage, rules, conditions, penalties, guidelines (both administrative and judicial), rationalizations, and struggle are used to produce a minimum of definite and understandable results, and to produce for us the most expensive system in the world.<sup>79</sup>

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<sup>78</sup> The Hon. R. Silverman Abella, "Address" (American Bar Association Convention, Toronto, 31 July 1998) [unpublished].

<sup>79</sup> This is based upon a statement by Daniel Cowans, a former bankruptcy judge, in D.R. Cowans, *Bankruptcy Law and Practice* (St. Paul, Minn.: West, 1963) at 101, when discussing the nature of a discharge. His words have been slightly paraphrased and expanded.